

Community Stabilization and Fair Rent Act
Fair Return Standard Regulations

CHAPTER 6
FAIR RETURN STANDARD

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A. Statement of Purpose

1. Authority.

Section 1700 of the Community Stabilization and Fair Rent Act (“Act”) states that one purpose of the voter-approved initiative is to control “excessive rent increases and arbitrary evictions to the greatest extent allowable under California law, while ensuring Landlords a fair and reasonable return on their investment.” Subsections (d)(1), (d)(2), and (e) of Section 1709, and subsection (a) of Section 1710 of the Act provide that the Rental Housing Committee has the authority to adopt and shall establish regulations to further the purposes of the Act.

2. Constraints.

Subsection (a) of Section 1710 of the Act authorizes petitions for upward adjustments of rents necessary to provide a Landlord with a fair rate of return. Subsections (a)(2) and (a)(3) define relevant factors that must be included and excluded from consideration when ensuring a fair rate of return. Among other factors to be considered when ensuring a fair rate of return, subsections (a)(2) and (a)(3) of Section 1710 require inclusion of capital improvements “necessary to bring the Property into compliance or maintain compliance with applicable local codes affecting health and safety,” and exclude the costs of “capital improvements that are not necessary to bring the Property into compliance or maintain compliance with applicable local codes affecting health and safety” and further exclude the costs of “ordinary repair, replacement, and maintenance.” Subsection (a)(3) of Section 1710 excludes from consideration when ensuring a fair rate of return the “costs of debt servicing (including but not limited to principal, interest, and fees) for any debt obtained after October 19, 2015” other than debt for qualifying capital improvements.

3. Purpose.

The purpose of this Chapter 6 is to implement the purposes of the Act by detailing the method of ensuring Landlords may earn a fair and reasonable rate of return on their investment, which shall be achieved through the maintenance of a Landlord’s net operating income as defined in this Chapter. Nothing in these regulations shall be interpreted to prohibit a Hearing Officer or the Rental Housing Commission from granting an individual Rent Adjustment that is demonstrated by the Landlord to be necessary to provide the Landlord with a fair rate of return.

B. Fair Return Standard

A Landlord's fair rate of return on investment for a property containing a Covered Rental Unit for the Petition Year is the "Adjusted Net Operating Income." For purposes of this Section (B), the Adjusted Net Operating Income shall equal the Net Operating Income for the Base Year, adjusted by the percentage increase or decrease in the Consumer Price Index between the Base Year and the Petition Year. If the Landlord's actual Net Operating Income for a property in the Petition Year is less than the Adjusted Net Operating Income, then the Landlord shall be entitled to an Upward Adjustment of Rents for that property sufficient to provide a Net Operating Income equal to the Adjusted Net Operating Income.

C. Definitions

For purposes of Chapter 6, the following definitions apply; all other capitalized terms are defined by the Act:

1. Base Year. The Base Year is calendar year 2015.
2. Capital Improvement. Capital Improvement is defined and shall be calculated as stated in Section F of this Chapter 6.
3. Gross Income. Gross Income is defined and shall be calculated as stated in Section D of this Chapter 6.
4. Consumer Price Index. Consumer Price Index is the Consumer Price Index for All Urban Consumers for "Rent of primary residence" in the San Francisco–Oakland–San Jose, California metropolitan area as published by the United States Department of Labor, Bureau of Labor Statistics and currently listed as Series No. CUURA422SEHA, as it may be revised.
 - a. Base Year Consumer Price Index. The Consumer Price Index for the Base Year shall be the annual average of the Consumer Price Index for 2015 (371.075).
 - b. Petition Year Consumer Price Index. The Consumer Price Index for the Petition Year shall be the Consumer Price Index that was most recently published as of the date a Petition for Upward Adjustment of Rent is submitted.
5. Net Operating Income. Net Operating Income is the Gross Income from one property that contains one or more Covered Rental Units, less Operating Expenses.

6. Operating Expense. Operating Expense is defined and shall be calculated as stated in Section E of this Chapter 6.
7. Petition Year. The Petition Year shall be defined as the calendar year for which the most recent Consumer Price Index data was published for the San Francisco-Oakland-San Jose area prior to acceptance of a Petition for Upward Adjustment of rent. If actual data for the complete Petition Year is not available, Net Operating Income shall be estimated in accordance with calculations defined in subsection (C)(2) of Chapter 6.

D. Calculation of Gross Income

Gross Income shall equal the total of the following:

1. Gross Rents lawfully collectible from each Rental Unit located on the property, calculated on the basis of one hundred percent (100%) rental occupancy for twelve (12) months; and
2. The imputed rental value of any owner-occupied Rental Unit or Rental Units; and
3. Income from coin-operated laundry facilities, vending machines, and similar income (but excluding rents and other income from any commercial space located on the property, if applicable); and
4. Interest from security, cleaning, and any other deposits received from Tenants (except to the extent paid to Tenants); and
5. All other income or consideration received or receivable in connection with the use or occupancy of the Rental Units and Housing Services; and
6. Less uncollected Rents due to vacancy and uncollectable debts, to the extent that the same are beyond the Landlord's good-faith efforts to ensure each Rental Unit is occupied and debts are paid. Any uncollected Rents due to vacancy are to be calculated at the Rent for the most recent tenancy. Any uncollected Rents in excess of three percent (3%) of Gross Income are presumed to be unreasonable unless established otherwise.

E. Calculation of Operating Expenses

1. Included Items. Operating Expenses shall include the following expenses to the extent they are incurred in connection with the operation of a property containing one or more Covered Rental Units:
 - a. The portion of annual fees assessed under Section 1709(j)(1) of the Community Stabilization and Fair Rent Act that is not allowed to be directly passed through to Tenants; and
 - b. Business license fees; and
 - c. Real property taxes; and
 - d. Utility costs paid by the Landlord, to the extent that such costs are not passed through to Tenants; and
 - e. Insurance; and
 - f. Reasonable costs for ordinary or routine repair, replacement, and maintenance of one or more Covered Rental Units and the property containing Covered Rental Units. Repair, replacement, and maintenance costs shall include, but not be limited to, building maintenance, including carpentry, painting, plumbing and electrical work, supplies, equipment, refuse removal, and security services or systems, cleaning, fumigation, landscaping, and repair or replacement of furnished appliances, drapes, and carpets; and
 - g. Reasonable management expenses (contracted or owner-performed), including necessary and reasonable advertising, accounting, or other managerial expenses. Management expenses are presumed to be six percent (6%) of Gross Income, unless established otherwise. Management expenses in excess of six percent (6%) of Gross Income are presumed to be unreasonable and shall not be allowed unless it is established that such expenses do not exceed those ordinarily charged by commercial management firms for similar residential rental properties; and
 - h. Reasonable Capital Improvement costs, as calculated in accordance with Section F of this Chapter 6; and

- i. Attorneys' fees and costs that are:
 - Incurred in connection with successful, good-faith attempts to recover Rents owed or with successful, good-faith unlawful detainer actions not in violation of applicable law, to the extent the same are not recovered from Tenants;
 - Legal expenses that are necessarily incurred in dealings with respect to the normal operation of the Covered Rental Units or property containing Covered Rental Units, to the extent such expenses are not recovered from adverse or other parties;
 - Reasonable costs incurred in obtaining an upward adjustment of Rent pursuant to the Act, including administrative or judicial proceedings in connection with the Act, except where the pass-through of such expenses is prohibited by the Rental Housing Committee or would constitute a violation of public policy;
 - Any attorneys' fees and costs included in Operating Expenses pursuant to this Section shall be amortized over a period of five (5) years, unless it is demonstrated that an alternate amortization period would be more reasonable.
2. Excluded Items. Operating Expenses shall not include:
 - a. Costs for additions or modifications or portion of an addition or modification that could have been avoided by the Landlord's exercise of reasonable diligence in making timely repairs after the Landlord knew or should reasonably have known of the problem that caused the damage leading to the repair; or
 - b. Income taxes; or
 - c. Costs arising from circumstances that arose before the current tenancy began; or
 - d. Any costs or expenses for which the Landlord has been or was eligible for reimbursement by another party, whether or not reimbursement was actually received, including reimbursements, rebates, or discounts offered by a government or utility (for example, incentives for alternative energy generation and energy-efficient appliances), security deposits, insurance proceeds, judgments for damages, settlements, or any other method or device; or

- e. Debt service, including mortgage interest and principal payments for the acquisition, improvement, or maintenance of Covered Rental Units and property containing Covered Rental Units; or
 - f. Any costs or expense incurred in conjunction with the purchase, sale, lease (excluding individual Rental Housing Agreements), financing, or refinancing of a Covered Rental Unit or property containing one or more Covered Rental Units, including, but not limited to, origination fees, credit enhancements, payments to real estate agents or brokers, appraisals, legal fees, accounting fees, etc.; or
 - g. Fees, other than fees expressly authorized by the Act or by the Regulations; or
 - h. Penalties, fees, or interest imposed for violation of the Act, the Regulations, or any other law; or
 - i. Legal expenses, other than those expressly authorized by the Act, or by the Regulations; or
 - j. Contributions to lobbying efforts or organizations which advocate on behalf of apartment owners on local, State, or Federal legislative issues; or
 - k. Depreciation; or
 - l. Any other expense that does not benefit the Covered Rental Units or the property containing the Covered Rental Units, including, but not limited to, the cost of forming or maintaining a corporation, partnership, or other entity or buying out a stockholder or partner of the Landlord.
3. Adjustments. The Hearing Officer shall have the discretion to reasonably adjust Operating Expenses for years with unusually high or unusually low Operating Expenses.

F. Capital Improvements

1. Requirements. “Capital Improvement” means additions to or modifications of a physical feature of a Covered Rental Unit or of a building or property containing a Covered Rental Unit. To qualify as a Capital Improvement, the addition or modification must:
 - a. Be necessary to bring the property or Covered Rental Unit into compliance, or to maintain compliance, with applicable building or housing codes, including, without limitation, additions or modifications made to prevent the occurrence of conditions listed in Mountain View City Code Section 25.58, the International Property Maintenance Code as incorporated by reference into the Mountain View City Code, and/or California Green Building Standards as codified in Chapter 4 (Residential Mandatory Measures) of Part 11 of Title 24 of the California Code of Regulations, as each may be amended or revised; and
 - b. Primarily benefit the Tenant, rather than the Landlord; and
 - c. Be permanently fixed in place or relatively immobile (for example, roofs, foundations, and window replacements may qualify in whole or in part as Capital Improvements).
2. Exclusions. The following are not eligible as Capital Improvements:
 - a. Costs of additions or modifications of a physical feature, or portions of additions or modifications, that could have been avoided by the Landlord’s exercise of reasonable diligence in maintaining and making timely repairs after the Landlord knew or should reasonably have known of the problem that caused the damage leading to the addition or modification; or
 - b. Use or installation of a Landlord’s personal appliances, furniture, etc., or those items inherited or borrowed; or
 - c. Ordinary or routine repair, replacement, or maintenance to a Covered Rental Unit or property containing a Covered Rental Unit; or
 - d. Overimprovements (for example, replacing a standard bathtub with a Jacuzzi bathtub), unless the Tenant approved the improvement in writing, the improvement brought the Covered Rental Unit up to current building or housing codes, the improvement was necessary to

meet California Green Building Standards, or the improvement did not cost more than a substantially equivalent replacement.

3. Amortization of Capital Improvements. For purposes of calculating annual Operating Expense pursuant to subsection (E)(1)(h) of this Chapter 6, the reasonable cost of each qualifying Capital Improvement shall be divided by the useful life of that Capital Improvement, which useful life shall be defined in an amortization schedule adopted by the Rental Housing Committee and included as an attachment to these Regulations.

G. Base Year Rebuttable Presumption

1. It is presumed that the Net Operating Income produced by a property during the Base Year provided a fair return on investment for the property. Landlords shall be entitled to maintain their Net Operating Income from year to year in accordance with this Chapter 6.
2. The Landlord, in a Petition for Upward Adjustment of Rents, may rebut the presumption that the Net Operating Income produced by a property during the Base Year provided a fair return on investment for the property by demonstrating peculiar circumstances unique to the property that caused either the Gross Income or Operating Expenses during the Base Year to differ significantly from either the Gross Income or Operating Expenses of other properties of similar size, quality, and conditions.
3. Vega Adjustment Standard.
 - a. Defining Unreasonably Low Average Monthly Rent. The Landlord, in a Petition for Upward Adjustment of Rents, will be presumed to have rebutted the presumption that the Net Operating Income produced by a property during the Base Year provided a fair return on investment for the property if the average monthly Rent received in the Base Year for an individual Rent Stabilized Unit in the property was unusually low. For purposes of this section, unusually low means that the average monthly Rent received for the occupancy and use of the Rent Stabilized Unit was less than the “fair market rents” published by the U.S. Department of Housing and Urban Development for Fiscal Year 2015 for Santa Clara County, as replicated in the table below, for the most similar unit type based on the number of bedrooms.

Efficiency	1-Bedroom	2-Bedroom	3-Bedroom	4-Bedroom
\$1,213	\$1,419	\$1,809	\$2,551	\$2,892

- b. Calculating the Average Monthly Rent Received in the Base Year for an Individual Rent Stabilized Unit. To calculate the average monthly Rent received in the Base Year, divide the sum of all Rent received that relates to one Rent Stabilized Unit by the number of months for which Rent was received for that unit, regardless of the number of tenants occupying, or the number of tenancies for, that Rent Stabilized Unit in the Base Year (e.g., if Unit X was occupied from January 2015 through June 2015 for \$1,000 per month, was vacant in July 2015, and was occupied from August 2015 through December 2015 for \$1,110 per month, then the average monthly Rent received in the Base Year for Unit X would be \$11,550 divided by 11 months of occupancy, or \$1,050 per month of occupancy).
- c. Recalculating Base Year Gross Income. If the average monthly Rent received for any individual Rent Stabilized Unit in the property during the Base Year was less than the fair market rents defined in subsection (a) of this Section G(3) above, then the Base Year Gross Income for the property shall be recalculated for purposes of determining the Base Year Net Operating Income by (1) subtracting the actual Rent received from each Rent Stabilized Unit for which the average monthly Rent received was unusually low, and (2) adding the fair market rent for the most similar unit type, for the same dates of occupancy and, in the same geographic area, as described above in subsection (a) of Section G(3).
- d. Contesting Recalculation of Base Year Gross Income. One or more Tenants may contest or dispute any recalculation of the Base Year Gross Income for purposes of determining the Base Year Net Operating Income in a Landlord's Petition for Upward Adjustment of Rents. Tenant arguments contesting or disputing any recalculation of the Base Year Gross Income may include, but are not limited to, evidence or documentation related to the physical condition of the property or any individual Rent Stabilized Unit, the market conditions that relate to the property or any individual Rent Stabilized Unit, and/or any other relevant evidence that a recalculation of the Base Year Gross Income, as contemplated in this Section G, is unnecessary for the landlord to receive a fair return on investment for the property, fails to ensure fairness, or is otherwise contrary to the purposes of the Act.
- e. Allocation of Upward Adjustment of Rents. The portion of any Upward Adjustment of Rents that results solely from the Vega Adjustment described in this Section G(3) shall be equally among all Rent Stabilized Units subject to the Petition, subject to the condition that in the interest

of justice, a Hearing Officer and/or the Rental Housing Committee may allocate Rent increases in another manner necessary to ensure fairness and further the purposes of the Act.

H. Estimation of Base Year Operating Expenses in the Absence of Base Year Operating Expense Records

If records demonstrating all or a portion of Base Year Operating Expenses for a property are unavailable, a Hearing Officer shall use the best information available to estimate any reasonable Operating Expenses for which reliable records are unavailable. The best information available may include reliable records from the property for another year, data or rate information or other sources of cost information may be considered in estimating the level of particular Operating Expenses in the Base Year. A Landlord, Tenant, the Rental Housing Committee, and/or a Hearing Officer may introduce information to estimate any reasonable Operating Expenses for which reliable records are unavailable, including increases or decreases in Operating Expenses between the Base Year and the Petition Year.

I. Retention of Base Year Records

Landlords are required to keep all financial records for the Base Year that may be necessary to confirm the Gross Income, or Operating Expenses, or both, for purposes of calculating the Net Operating Income for the property. Failure to retain Base Year records confirming Gross Income, or Operating Expenses, or both, for the Base Year shall not, of itself, rebut the presumption that the Net Operating Income produced by a property during the Base Year provided a fair return on investment for the property. Failure to retain Base Year records may require estimation to calculate Base Year Net Operating Income as defined in Section E of this Chapter.

J. Allocation of Upward Adjustment of Rents

Upward Adjustments of Rents authorized by Hearing Officers and/or the Rental Housing Committee shall be allocated equally among all Rental Units in the property, subject to the condition that in the interests of justice, a Hearing Officer and/or the Rental Housing Committee may allocate Rent increases in another manner necessary to ensure fairness and further the purposes of the Act.

K. Partial Invalidity

If any provision of this Chapter 6, or the application thereof to any person or circumstance, is held invalid, this invalidity shall not affect other provisions or applications of this Chapter 6 or these Regulations that can be given effect without the invalid provision or application, and to this end the provisions of this Regulation are declared to be severable. The Regulation shall be liberally construed to achieve the purposes of the Act.